(3)

FILED
NOV 9 1994
CLERK

No. 94-404

In the Supreme Court of the United States

OCTOBER TERM, 1994

CHARLES A. ROTH, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

DREW S. DAYS, III
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

SIMON M. LORNE
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

LUCINDA O. MCCONATHY
Assistant General Counsel

SUSAN K. STRAUS
Attorney
Securities and Exchange Commission
Washington, D.C. 20549

QUESTION PRESENTED

Whether Section 15(a)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78*o*(a)(1), requires a person employed by a registered securities broker to register himself as a securities broker when he provides brokerage services independent of his employer.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	2
Statement	2
Argument	10
Conclusion	15

TABLE OF AUTHORITIES

Cases:

Chevron U.S.A. Inc. v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)	10, 13
City Capital Associates Ltd. Partnership v. *Interco Inc.*, 860 F.2d 60 (3d Cir. 1988)	13
Gates & Fox Co. v. *OSHRC*, 790 F.2d 154 (D.C. Cir. 1986)	13
Kennedy v. *Mendoza-Martinez*, 372 U.S. 144 (1963)	13
Kordel v. *United States*, 335 U.S. 345 (1948)	12
Landreth Timber Co. v. *Landreth*, 471 U.S. 681 (1985)	12
Moskal v. *United States*, 498 U.S. 103 (1990)	12
Satellite Broadcasting Co. v. *FCC*, 824 F.2d 1 (D.C. Cir. 1987)	13
SEC v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943)	11
SEC v. *Chenery Corp.*, 332 U.S. 194 (1947)	12
SEC v. *Ridenour*, 913 F.2d 515 (8th Cir. 1990)	10
United States v. *Brown*, 333 U.S. 18 (1948)	12
United States v. *R.L.C.*, 112 S. Ct. 1329 (1992)	12
United States v. *Thompson/Center Arms Co.*, 112 S. Ct. 2102 (1992)	11, 12

Statutes :

Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.*:	
§ 3(a)(4), 15 U.S.C. 78c(a)(4)	4
§ 15(a)(1), 15 U.S.C. 78o(a)(1)	2, 3, 4, 8, 9, 10, 11, 12, 13, 14

Statutes—Continued: Page

§ 15A, 15 U.S.C. 78*o*-3 (1988 & Supp. V 1993) 2, 3
§ 19, 15 U.S.C. 78s 2, 3
§ 19(d)(2), 15 U.S.C. 78(d)(2) 3
§ 19(e)(1), 15 U.S.C. 78(e)(1) 3
§ 25(a), 15 U.S.C. 78y(a) 3
§ 32(a), 15 U.S.C. 78ff(a) 11

Miscellaneous:

NASD Manual:
¶ 2151 (1991) 4
¶ 2177 (1985) 5
¶ 2200 (1991) 7

In the Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-404

CHARLES A. ROTH, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A5)[1] is reported at 22 F.3d 1108. The opinion of the Securities and Exchange Commission, Securities Exchange Act Release No. 31085 (August 25, 1992) (Pet. App. B1-B17), is unreported, but appears at 52 S.E.C. Docket 1314.

---

[1] The appendix to the Petition includes the court of appeals' opinion, with pages numbered 1-5, and the Commission's opinion and order, with pages numbered 1-18. To facilitate reference to the appendix, references to the court of appeals' opinion will be in the form "Pet. App. A__" and references to the Commission's opinion and order will be in the form "Pet. App. B__".

JURISDICTION

The judgment of the court of appeals was entered on March 16, 1994. A petition for rehearing was denied on June 2, 1994. Pet. App. C1. The petition for a writ of certiorari was filed on July 14, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner, a securities broker, worked both on his own and as an employee of a broker-dealer firm, R.B. Marich, Inc. (Marich). The firm was registered with the Securities and Exchange Commission (Commission) as a broker-dealer and was a member of the National Association of Securities Dealers, Inc. (NASD). Petitioner was not, however, independently registered as a broker with the Commission. The NASD disciplined petitioner for engaging in securities transactions without being registered as a broker, in violation of Section 15(a)(1) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78*o*(a)(1), and without giving Marich prior written notice of the transactions, in violation of Article III, Section 1 of the NASD Rules of Fair Practice and Article III, Section 40 of those Rules as amended. Pet. App. A2, B3 & n.2. The Commission sustained the disciplinary action, Pet. App. B1-B18, and the court of appeals affirmed, Pet. App. A1-A5.

1. The NASD is a national securities association registered with the Commission under Section 15A of the Exchange Act, 15 U.S.C. 78*o*-3 (1988 & Supp. V 1993). It thus is responsible for regulating its member firms and persons associated with its members, subject to comprehensive oversight by the Commission. See 15 U.S.C. 78*o*-3, 78s. To that end, the NASD is authorized to impose disciplinary sanctions on its member firms and

persons associated with such firms. *Ibid.* Disciplinary action taken by the NASD is subject to review by the Commission. 15 U.S.C. 78s(d)(2) and (e)(1). On review, the Commission considers the record *de novo* and makes its own factual findings and legal conclusions. 15 U.S.C. 78s(e)(1). The Commission's decisions are subject to judicial review. See 15 U.S.C. 78y(a).

2. This case involves petitioner's participation in seven securities transactions in 1985 and 1986. Pet. App. B3-B6. Petitioner conducted those transactions as part of a securities business he ran outside the scope of his employment with Marich. In that business, he specialized in insurance securities, including assisting insurance companies in locating and purchasing shares of their own outstanding stock, and purchasing stock in other insurance companies. *Id.* at B3. Petitioner maintained his independent business at an office separate from Marich, employed his own secretary, used his own business stationery that did not indicate any association with Marich, billed clients and received payment in his own name, and kept records apart from the firm's. *Id.* at A4-A5 & n.1, B3, B13. He did not give the firm prior written notice of the seven transactions. *Id.* at B2. He worked on those transactions "autonomously," with "negligible" supervision, and "without the licensing authority of a broker dealer." *Id.* at A5.

3. a. The NASD brought charges against petitioner for violation of the broker-dealer registration requirements of the Exchange Act and for violation of the NASD Rules requiring a person associated with a member firm to give written notice to the firm before engaging in any private securities transactions outside the scope of his association with it. Section 15(a)(1) of

the Exchange Act, 15 U.S.C. 78o(a)(1), makes it unlawful for

> any broker or dealer which is * * * a natural person not associated with a broker or dealer * * * to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any [non-exempt] security * * * unless such broker or dealer is registered [with the Commission].

Section 3(a)(4) of the Act, 15 U.S.C. 78c(a)(4), defines the term "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." Article III, Section 1 of the NASD Rules provides:

> A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

NASD Manual ¶ 2151, at 2014 (1991). When the first three of the seven transactions charged occurred, the Board of Governors' Interpretation of Article III, Sections 1, 27 and 28 provided, in pertinent part:

> Depending upon all the facts and circumstances, private securities transactions effected outside the usual or normal course or scope of employment and nowhere reflected on broker/dealer books and records may expose the participants to charges of serious violations of federal securities laws, as well as industry rules and regulations, and to civil liability. In some instances, severe sanctions have been imposed on registered and associated personnel for engaging in private securities transactions effected outside the scope of their association and nowhere reflected on broker/dealer books and records.

> Persons associated with a member should also be aware that their involvement in private securities transactions outside the scope of their association as a member may raise serious questions regarding their need to register as broker/dealers and/or investment advisers under state and federal securities laws. * * *
>
> * * * * *
>
> It shall be deemed conduct inconsistent with just and equitable principles of trade for any person associated with a member to engage in a private securities transaction outside the regular course or scope of his association or employment with a member, for himself, or with or for any other person without prior written notification to the member.

NASD Manual ¶ 2177, at 2109-2 to 2109-3 (1985). Following an amendment effective November 12, 1985, Article III, Section 40 of the NASD Rules provided, in pertinent part:

> (a) *Applicability*—No person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this section.
>
> (b) *Written notice*—Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may

receive selling compensation in connection with the transaction * * *.

(c) *Transactions for Compensation* —

(1) In the case of a transaction in which an associated person has received or may receive selling compensation, a member which has received notice * * * shall advise the associated person in writing stating whether the member: (A) approves the person's participation in the proposed transaction; or (B) disapproves the person's participation in the proposed transaction.

(2) If the member approves a person's participation in a transaction pursuant to Subsection(c)(1), the transaction shall be recorded on the books and records of the member and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member.

(3) If the member disapproves a person's participation pursuant to Subsection (c)(1), the person shall not participate in the transaction in any manner, directly or indirectly.

* * * * *

(e) *Definitions*—For purposes of this section, the following terms shall have the stated meanings:

(1) "Private securities transaction" shall mean any securities transaction outside the regular

> course or scope of an associated person's employment with a member[.]

NASD Manual ¶ 2200, at 2186-2187 (1991).

An NASD hearing panel found that petitioner committed each of the violations charged. SEC R. 155-161. It censured him, fined him $20,000, and suspended him for twenty days from association with any NASD member. *Id.* at 161. On review, following a supplemental evidentiary hearing, the NASD Board of Governors affirmed the panel decision as to the violations. *Id.* at 400-405. It modified the sanctions by (1) extending to six months the period of petitioner's suspension, (2) imposing a requirement that petitioner re-qualify by examination before he could again become an associated person of an NASD member firm, and (3) imposing a fine of $510,038, based on the amount of compensation that petitioner received in connection with the transactions forming the basis of the charges against him. *Id.* at 405; Pet. App B2.

b. Petitioner applied to the Commission for review of the NASD's decision. Based on an independent review of the record, the Commission affirmed in part. Pet. App. B1-B18. It held that petitioner had violated the NASD Rules in six of the seven transactions charged by failing to give Marich prior written notice.[2] Petitioner's failure

---

[2] Petitioner contended that the transactions were sales of businesses and therefore, under the "sale of business" doctrine, not deemed to be securities transactions. Because this Court did not reject the sale of business doctrine until 1985, see *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681 (1985), after one of the seven transactions had been completed, the Commission set aside the NASD's finding of a violation with respect to that transaction. Pet. App. B6-B8.

to register as required by Section 15(a)(1) constituted a seventh violation. The Commission reasoned that the transactions were not effectuated through Marich so as to exempt petitioner from the prior written notice requirement, Pet. App. B10; rather, petitioner "operated as an independent broker," *id.* at B13. With respect to the Section 15(a)(1) violation, the Commission explained:

> Section 15(a)(1) was designed to ensure that customers would in all instances receive either the regulatory protections that result from a salesman being registered himself or the protections that stem from the salesman being supervised by a registered firm. Here, [petitioner's] registration with Marich did not provide the protections envisioned by Congress. On the contrary, [petitioner] engaged in extensive securities activities that were concealed from his employer and went far beyond the scope of his association with that firm. In those circumstances, [petitioner] was required to obtain independent registration as a broker-dealer.

Pet. App. B12-B13.

The Commission sustained the censure, the six-month suspension, and the re-examination requirement. Pet. App. B18. It reduced the fine, however, because the NASD had given notice to petitioner at the time he was charged that the maximum fine per violation was $15,000. *Id.* at B14-B16. The Commission calculated the maximum appropriate fine to be $105,000, based on six notice violations and one registration violation. *Id.* at B16. Imposition of such a fine was appropriate, the Commission concluded, because, among other reasons, it was "substantially less than the fees [petitioner] earned from his violative conduct." *Id.* at B17.

c. The court of appeals affirmed. Pet. App. A1-A5. The court rejected petitioner's contention that his association with the Marich firm relieved him of responsibility to register. The court noted:

> The language of § 15(a)(1) does not make plain whether registered representatives like [petitioner] are always exempt from registration as broker-dealers, or whether the exemption from broker-dealer registration extends only to those individuals subject to the supervisory relationship which normally accompanies association with a member firm.

Id. at A4. The court reasoned, however, that the purpose of the registration requirement—to ensure that unregistered brokers come within the supervisory ambit of a registered broker-dealer—would not be served by allowing the mere fact of association with a broker-dealer to legitimize transactions made wholly independent of the registered entity. *Ibid.* The employer's registration binds it "to abide by numerous regulations designed to protect prospective purchasers of securities, including standards of professional conduct, financial responsibility requirements, recordkeeping requirements, and supervisory obligations over broker-dealer employees." *Ibid.* The court explained that "[i]f an individual is operating as a broker-dealer outside the scope of his employment, the employer's registration would seem to have little relevance." *Ibid.* Adhering to the Commission's and the Eighth Circuit's interpretation of Section 15(a)(1), the court thus held that petitioner's participation in securities transactions outside the scope of his employment with Marich, without registering, violated the Act. Pet. App. A5,

citing *SEC* v. *Ridenour*, 913 F.2d 515, 517 (8th Cir. 1990).[3]

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore unwarranted.

1. Petitioner contends (Pet. 31-36) that the court of appeals' interpretation of Section 15(a)(1) should be rejected because, in petitioner's view, the court impermissibly gave deference under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), to the Commission's interpretation of a statute that petitioner characterizes as penal. No deference to the Commission is required, however, because the interpretation of Section 15(a)(1) adopted by the court of appeals is the only reasonable reading of the statute. See, *e.g.*, *SEC* v. *Ridenour*, 913 F.2d 515, 517 (8th Cir. 1990) (holding, without reliance on *Chevron*, that Section 15(a)(1) does not permit a person associated with a registered firm independently to conduct a securities business without separately registering). Section 15(a)(1) requires that all brokers either be registered themselves or associate with a registered broker. The purpose of the registration requirement is to ensure that every person acting as a broker is subject to regulatory oversight, which in turn protects the public and the securities market. Thus, even without the aid of

---

[3] The court of appeals also summarily rejected petitioner's contentions that the NASD's private transactions rules and penalty provisions are unconstitutionally vague, that the Commission's decision was not supported by substantial evidence, and that the sanction was excessive. Pet. App. A2-A3.

the Commission's interpretation, the meaning of Section 15(a)(1) is evident.

As this case illustrates, petitioner's interpretation would undermine Section 15(a)(1) by permitting a person to rely on the registration of a firm with which he associates to legitimize his conduct of a wholly separate securities business bearing no relationship to that association and unbeknownst to the registered firm. Registration provides the link through which the Commission ensures that brokers comply with statutory and regulatory investor protection requirements. Petitioner's reading of the statute would break that link to associated persons acting on their own, thereby creating a major loophole in the Commission's system of broker-dealer regulation. That loophole cannot be squared with congressional intent to ensure comprehensive regulation through the registration requirement.

Although petitioner was subject only to civil sanctions in this case, he suggests (Pet. 34) that the availability of criminal sanctions for willful violations of the Act, see 15 U.S.C. 78ff(a), requires that Section 15(a)(1) be strictly construed. Rules of strict construction of criminal statutes do not apply when the statute is interpreted, as here, in a non-criminal context. See *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 353-355 (1943) ("[t]he weight of authority is committed to a liberal construction" of securities laws containing both civil and criminal penalties when they are applied in civil cases).[4]

---

[4] The additional element of willfulness that must be proved to support a criminal violation of the Exchange Act distinguishes it from the National Firearms Act, which this Court strictly construed in *United States* v. *Thompson/Center Arms Co.*, 112 S. Ct. 2102, 2109-2110 (1992) (plurality opinion). In *Thompson/Center*,

Even if strict construction were appropriate, however, it would not require a different result. "[T]here is no canon against using common sense in reading a criminal law, so that strained and technical constructions do not defeat its purpose by creating exceptions from or loopholes in it." *Kordel* v. *United States*, 335 U.S. 345, 349 (1948). The requirement that penal statutes be strictly construed "is satisfied if the words are given their fair meaning in accord with the manifest intent of the lawmakers." *United States* v. *Brown*, 333 U.S. 18, 26 (1948). See also *United States* v. *R.L.C.*, 112 S. Ct. 1329, 1338 (1992) (plurality opinion) ("[W]e have always reserved lenity for those situations in which a reasonable doubt persists about a statute's intended scope even *after* resort to 'the language and structure, legislative history, and motivating policies' of the statute."), quoting *Moskal* v. *United States*, 498 U.S. 103, 108 (1990). This is especially true of Section 15(a)(1), the scope of which is unmistakable in light of the detailed (and unchallenged) NASD Rules prohibiting a person associated with a registered broker from providing brokerage services wholly independently of his firm. See pp. 5-6, *supra*.

Deference to the Commission's interpretation is, in any event, wholly appropriate. See *SEC* v. *Chenery Corp.*, 332 U.S. 194, 207 (1947) ("Our duty is at an end when it becomes evident that the Commission's action is based upon substantial evidence and is consistent with the authority granted by Congress."). Although the Exchange Act includes criminal penalties, it is

---

the "rule of lenity" was held to be appropriate in the civil context because "the NFA has criminal applications that carry no additional requirement of willfulness." *Id.* at 2109 (plurality opinion).

fundamentally regulatory, not penal. See *Kennedy* v. *Mendoza-Martinez*, 372 U.S. 144, 168-169 (1963) (enumerating factors relevant to determining whether a statute is penal or regulatory). The Exchange Act provides for close regulation of the securities industry. It includes requirements as to the proper conduct of brokerage businesses and provides for Commission oversight and administration of a broad range of investor protection requirements. Violations need not be intentional to subject the violator to remedial sanctions such as those imposed on petitioner in this case. In sum, the Commission "has been entrusted by Congress with the interpretation, administration, and enforcement of the Securities Acts," and in the absence of "a conflict between those interpretations and the Congressional mandate," deference is due. *City Capital Associates Ltd. Partnership* v. *Interco Inc.*, 860 F.2d 60, 64 (3d Cir. 1988).

Petitioner has not identified any cases declining to defer to the Commission's reasonable interpretation of the Exchange Act, nor has he cited any cases interpreting Section 15(a)(1) not to require associated persons to register separately when they act as independent brokers. The bulk of cases he cites involved other agencies, and gave deference under *Chevron*. See Pet. 32-33 (citing cases). The cases in which *Chevron* deference was inappropriate involved circumstances clearly distinguishable from this case.[5]

---

[5] In *Satellite Broadcasting Co.* v. *FCC*, 824 F.2d 1 (D.C. Cir. 1987), the court did not defer to the Federal Communications Commission's application of its own rule requiring certain applications to be filed in Gettysburg, Pennsylvania, rather than in the District of Columbia, because the FCC failed to give clear notice where applications were to be filed. Similarly, in *Gates & Fox Co.* v. *OSHRC*, 790 F.2d 154 (D.C. Cir. 1986), the court did

2. Petitioner's other arguments also lack merit. Petitioner contends (Pet. 36-38) that the Commission's interpretation of Section 15(a)(1) is unreasonable and violates his due process rights because it holds him responsible for his employer's failure to supervise him. There is, however, no due process impediment to holding employees rather than their employers responsible for employee conduct outside the scope of employment. The statute placed such responsibility on petitioner. He was sanctioned for his own defalcation, not that of his firm.

Petitioner also contends (Pet. 38-40) that the Commission failed to articulate reasons supporting its decision. In fact, the Commission explained that petitioner was subject to sanctions because his conduct "deprived those with whom he dealt of protections they had a right to expect and exposed his nominal employer to unwarranted risks." Pet. App. B17. It noted that petitioner's violations were extensive, *id.* at B10, B12, and that he concealed them from his firm, *id.* at B12. The Commission also explained that the amount of the monetary sanction was reasonable because it fell far short of the amounts petitioner earned from the violations. *Id.* at B17. Those statements more than sufficed to explain the basis for the sanctions imposed.

---

not defer to the Department of Labor's interpretation of an Occupational Safety and Health Act regulation that gave constitutionally inadequate notice that the employer could be sanctioned for failing to provide rescue equipment to certain employees. Here, in contrast, in light of the unmistakable purpose of Section 15(a)(1) and the guidance provided by the related NASD Rules, there is no question that petitioner was on notice that he should have registered with the Commission.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

SIMON M. LORNE
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

LUCINDA O. MCCONATHY
Assistant General Counsel

SUSAN K. STRAUS
Attorney
Securities and Exchange Commission

NOVEMBER 1994